

# To Bond or Not to Bond?

## That is the Question



Mike Hergott,  
Senior Vice President  
Arthur J. Gallagher Canada Limited



To bond or not to bond has been a debate by many owners of construction projects for years. Often the argument against bonding contractors is that it adds additional cost to the project. This “additional cost” coupled with an accompanying view that a contractor is unlikely to default or become insolvent during the project, appears a convincing argument. However, often the subscribers to this rationale are not appreciating the full function of what purpose bonds serve when the “going gets tough.”

Subscribers to the “against bonding debate” tend to be met with surprises on a project when they face significant increases in construction costs and burden from increased administration and legal requirements in the event of a defaulted construction contract. The situation can deteriorate further when we consider that it is not just a failure to perform the contract, but also that it creates more issues when a hired contractor fails to pay its subcontractors on the project.

Requiring contractors to post bonds on projects provides the owner assurance in a number of areas. The common construction contract bonds that are requested are for performance obligations and labour and material payment obligations. These in turn guarantee the performance of the contract obligations regardless of the contractor’s financial position or capabilities, as well as ensures that direct subcontractors involved in the contract will be paid for the work. For a condo corporation, this is particularly helpful in protecting the project budget and to protect the reserve fund’s long term health with regards to capital intensive projects or maintenance.

Specific to condo corporations, outside of the potential costs arising from a contractor’s failure to perform or satisfy its payment obligations, there is additional exposure for directors and officers of the corporation. The obligation and duty of the directors and officers

extends to protecting the balance sheet of the corporation by adhering to the duties of loyalty, care and prudence. Anything that they do, or do not do, in terms of fulfilling these obligations and discharging these duties that results in financial harm to the corporation they are obligated to safeguard, can be grounds for a claim against them by unit holders on behalf of the corporation.

For example, consider a non-bonded contractor that defaults under the contract. The corporation could face significant completion issues as well as increased expenses in finishing the project and seeking to recover from a potentially insolvent or defunct contracting operation. Ultimately, these events, and often significant additional costs, could lead to allegations against the directors and officers. In today’s litigious environment, these allegations can quickly arise referring to directors’ and officers’ failure to conduct proper due diligence, receive reasonable assurances as to the contractor’s capabilities (i.e. bonds) and the contractor’s capacity to complete the work is what led to the loss for the unit holders and the corporation as a whole.

It is wise for owners of construction projects considering the use of bonds to seek legal advice with respect to the exposures that can face the corporation and its directors and officers. Owners should also make efforts to ensure they fully understand the functionality of bonds, not only to help in making their decisions, but to also be able to demonstrate due diligence as directors and officers in validating their decisions. Engaging in conversation and becoming educated buyers of this product can be easily arranged by speaking to an insurance broker who specializes in construction and is practiced and involved routinely in the use of construction contract bonds. ■

*Mike Hergott, Senior Vice President, Arthur J. Gallagher Canada Limited*